In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-432

COMMUNITY BANK, ET AL., PETITIONERS

v.

FEDERAL RESERVE BANK OF SAN FRANCISCO, AND BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENTS IN OPPOSITION

Petitioners contend that Regulation J of the Federal Reserve System, as applied to nonmember, nondepositor banks, is inconsistent with the Uniform Commercial Code and unauthorized by federal statute.

On June 21, 1972, the Board of Governors of the Federal Reserve System approved changes in Regulation J, 12 C.F.R. 210 (Pet. App. C, pp. C-2 to C-5), which governs the collection of checks and other items by Federal Reserve Banks. Petitioners are state-chartered banks that are neither members of nor affiliated with the Federal Reserve System.

Briefly stated, the changes in Regulation J affect both the time and manner in which payor banks must settle for demand items presented for collection by Reserve Banks. Prior to the amendments banks were permitted to pay demand items, presented by Reserve Banks for payment, by remitting a draft on another bank by midnight of the banking day of receipt of the item. By the time the draft could in turn be collected by the Federal Reserve Bank, approximately two days had passed since presentation. This delay, or "float," represented a loss in liquidity to the Federal Reserve Bank, and a corresponding gain to banks such as petitioners.

The amendments to Regulation J advance the payment time to the close of business on the day of receipt, and settlement for an item may be revoked only if payment is made prior to this time. The amendments also require payment in immediately available funds, thus eliminating drafts drawn on other banks as permissible forms of payment.[1]

The purpose of the amendments is to increase the speed of the Federal Reserve's check collection services, and to reduce the "float", which in the past has approximated $2 billion each day.

Petitioners challenge the amendments to Regulation J on two broad grounds. First, they urge that the changes are inconsistent with the time and manner of settlement provisions contained in California's enactment of the Uniform Commercial Code, which they contend should govern the operations of nonmember banks chartered under the laws of the State of California. Second, they argue that, to the extent that the amendments attempt to bind payor banks that are not members of the Federal Reserve System, the amendments to Regulation J exceed the power conferred on the Board under the Federal Reserve Act.

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[1]Prior to the amendments the time and manner of settlement provisions of Regulation J and the Uniform Commercial Code (as adopted in the California Commercial Code) were virtually identical.

Under the amendments the collecting Federal Reserve Bank is required to charge back to the sender the amount of any check for which payment is not made by the close of business on the banking day of receipt (Pet. App. C, pp. C-4 to C-5).

The district court rejected each of these contentions, and upheld the Board's amendments to Regulation J (Pet. App. A, pp. A-1 to A-19). The court of appeals affirmed (Pet. App. B; 500 F.2d 282). Accord, *Independent Bankers Association* v. *Board of Governors of the Federal Reserve System*, 500 F.2d 812 (C.A.D.C.).[2] There is no conflict among the circuits or with any decision of this Court, and accordingly there is no occasion for plenary review.

1. The court of appeals correctly decided that the revisions of Regulation J were not inconsistent with California law (Pet. App. B, pp. B-5 to B-12). Section 4103(2) of the California Commercial Code provides that "Federal Reserve regulations and operating letters, clearing-house rules, and the like, have the effect of agreements * * * whether or not specifically assented to by all parties interested in items handled." The Code also provides (Section 4103(1)) that other provisions relating to bank collections may be varied "by agreement." The effect of these two interlocking provisions is to provide that provisions of the Code otherwise applicable to bank collections may be varied by regulations of the Federal Reserve System; in effect, the federal regulations are incorporated by the Code into state law. See Uniform Commercial Code (1958 Supp. to 1957 Official Text), Section 4-103, official Comment 3: "Consequently, such official or quasi-official rules may, standing by themselves * * * vary the effect of the provisions of Article 4 [of the Code]."

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[2]The District of Columbia Circuit also there held that the Federal Reserve Board had sufficiently taken into account the interests of nonmember banks in its amendments to Regulation J.

In any event, petitioners' claim (Pet. 17-21) that the court of appeals has misconstrued California state law presents no issue warranting review by this Court.

2. Petitioners' argument that Regulation J exceeds the power of the Federal Reserve System, as construed in *Farmers and Merchants Bank of Monroe* v. *Federal Reserve Bank of Richmond*, 262 U.S. 649, is inaccurate. The court of appeals fully answered this contention in its opinion, on which we rely (Pet. App. B, pp. B-13 to B-16):

> The authority of Reserve Banks * * * includes the power to collect checks drawn on nonmember banks. *See American Bank and Trust Co.* v. *Federal Reserve Bank of Atlanta*, 262 U.S. 643 (1923). The Board is also authorized to promulgate rules and regulations necessary to the performance of its functions. 12 U.S.C. §248(i). *See also* 12 U.S.C. §248(o).
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> There is nothing in [*Farmers and Merchants Bank*] that supports the appellants. The Court only recognized the right of a state to alter the common law rules relating to bank collections. Here we only recognize the right of the Federal Reserve to promulgate rules with respect to check collections in a manner countenanced by applicable state law. Neither the Federal Reserve here nor North Carolina in *Farmers and Merchants Bank* has acted beyond its power.
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> Since the amendments to Regulation J do not, in our view, represent an attempt to establish a universal system of check clearance, appellants' reliance on *Farmers and Merchants Bank* is misplaced. Because the State Banks are not required to use Federal Reserve routing numbers on their checks, and because alternatives exist to the use of such numbers, the system must be characterized as essentially voluntary. Under such circumstances, the amendments to Regulation J cannot be viewed as an attempt by the Board to establish a universal system of check collection. If the amended Regulation J proves too onerous to the State Banks, they are free to remove themselves from the system. [Footnote omitted.]

If they wish, petitioners may avoid the effect of Regulation J by declining to have their checks processed through the Federal Reserve's check collection system. Such removal is feasible; more than 200 banks that do not accede to the Federal Reserve System's desire to clear all checks at par have established alternate methods of check payment. See Pet. App. A, p. A-15. Although petitioners assert that this method would be inconvenient because it would require that "each and every one of Petitioners' depositors have new checks printed and encoded with a new number" (Pet. 19), petitioners are not entitled to use this allegation of inconvenience to compel the Federal Reserve System permanently to provide them with the substantial unearned benefits that now accrue to them because of the "float."

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

DECEMBER 1974.